

Feb. 21, 1990

Letter 1037

WOW! Iron Mike Tyson knocked silly, "Trump, the Divorce" making headlines, Drexel Burnham Lambert and Integrated Resources going belly up, the Bush Administration against the wall on Social Security taxes -- hey don't tell me the 1990s aren't going to be exciting!

THE MARKET: Around the end of the year there was a lot of talk about "the January effect," which was supposed to be a sure-shot way of making money by buying depressed stocks in December and selling them for a profit in January. Only it didn't work this year.

Then there's the predictive value of January, known as the "January barometer" ("as January goes, so goes the year"). I've never been enamored of mechanical methods of "predicting" the market, be it the January barometer, the Superbowl indicator, or the hemline thesis.

However, Bob Farrell of Merrill Lynch notes that there have only been two previous Januarys in which the S&P was down 7% or more. They occurred in 1960 and 1970 -- both initial years in new decades and both bear market years. This January the S&P was down 7% again.

The year 1990 was one of those unusual years in which the December low for the Dow was broken in January. So I went through my chartbook of the D-J Averages looking for previous instances when the Dow broke below its December low in January. This has happened on a number of occasions in the past -- 1984, 1982, 1978, 1973, 1970, 1966, and 1962. The results were not always the same, but in most cases the full year was not a good one. In general, if the Dow's December low cannot hold in January it is a bearish omen for the market, at least for the intermediate term.

BEAR MARKETS: No two bear markets are, or have ever been, the same. Some, like 1929-32 or 1937-38, have been crushing, relentless, yet strangely rhythmic and easy to follow. And other bear periods, like 1966 to 1974, have been convoluted, erratic, and totally confusing -- with students still arguing about what happened and when those bear markets actually ended.

A bear market started in January 1973 at 1051.70 on the Dow. The Dow dropped to 851.90 in August, then rallied to a high of 987.06 in September. During October-November, the market fell apart. The Dow moved irregularly sideways during the first five months of 1974 (although the advance-decline ratio continued to cave in). From June to December (the bear market ended in December), Wall Street was a horror show.

So much for a bit of history, but what's in store for us now? Sadly, I must report that there isn't a man or woman on the face of this green earth who can answer that one with any degree of certainty. In fact, history may even disagree about when this bear market started.

As I explained earlier, the Dow Theory will record this bear market as having started on September 5, 1989. That was the day when BOTH Averages (D-J Industrials and Transports) recorded their last highs together. That takes care of the Averages themselves, but how about the question of when the bear market started for the majority of stocks?

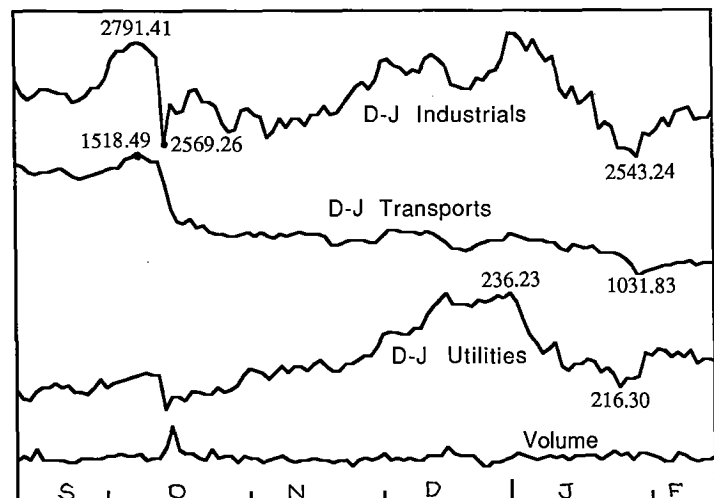
Feb. 9 DJIA 2648.20; PTI 3273; A-D Ratio -9.63
Feb. 15 DJIA 2649.55; PTI 3273; A-D Ratio -9.79
Dow Yield: 3.79%; Dow P/E: 11.6; DowPow: 329
Dow Book Value: 1075; Dow 200-day MA: 2626
Percentage of Undervalued Blue-chips: 21%
PTI 89-day Moving Average: 3280

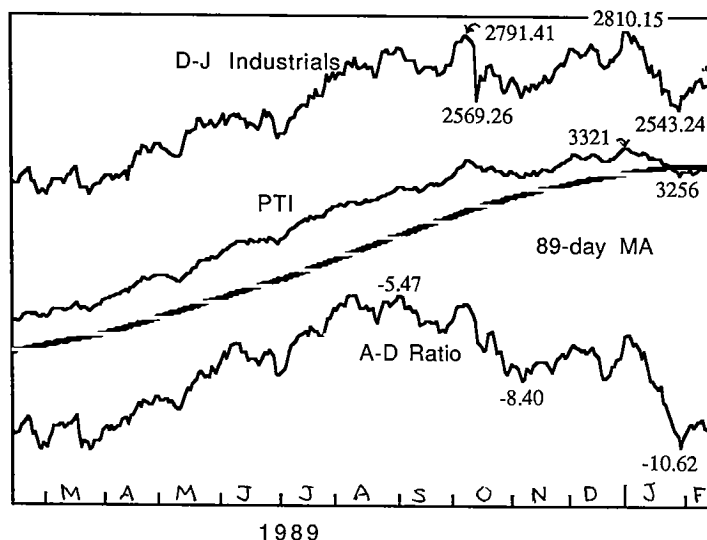
For instance, the broad Value Line Average hit its bull market high in August 1987. But since the 1989 peak in the Value Line was a full 10 points below the '87 peak, one could argue that, for the majority of stocks, the bear market actually began back in August 1987. The S&P 500 Composite traced out an almost perfect double top during the October 1989 to January 1990 period, and from this standpoint one might say that the bear market for most stocks started around October 1989. The NYSE Index topped out in October 1989 as did the very broad Wilshire 5000. My Primary Trend Index hit its high on January 2, 1990, simultaneously with the Dow.

What else do we know about bear markets that may be helpful? Looking back over history, we know that the majority of primary bear markets have wiped out 50% or more of the ground gained by the preceding bull market. Hardly a happy thought, but a valuable concept when gauging how far a bear market might conceivably carry.

Which brings up the next question. When did the preceding bull market start? Personally, I put the beginning of the great bull market at Dow 577 back in December 1974. If that's the case, the bull tacked on 2233 points during his 15-year reign from 1974 to 1989. Half of that number is 1116, and adding that to the 577 Dow low gives us a midway point of 1693.

From another angle, almost all major bear markets have taken the Dow down to where it ultimately yields 6% or better. If current dividends hold, at a level of 1693 the Dow would yield 5.9%. So the 1693 level would not seem out of line if the Dow were to go back to the bargain levels found at a bear market bottom. Of course, that tabulation is based on current Dow dividends of \$100.18. During bear markets, dividends tend to be cut, so that 1693 figure might end up on the high side if a return of 6% is used as the target.





All the above is strictly within the realm of guessing and conjecture. Bear markets, like bull markets, are chock full of surprises. And just as true primary bull markets usually take stocks and the averages higher than anyone thinks possible, so primary bear markets have a habit of taking stocks and the averages lower than anyone wants to think about.

Primary bear markets are subject to three psychological phases (these phases not to be confused with price movements) The first phase of a bear market is the one where stocks sell minus the froth, foam, and excitement of the previous bull market top. This phase usually comes as a shocker -- often with a crash.

The second phase of a bear market is the one where stocks go down in response to obviously deteriorating business conditions. In the second phase, we see many stocks collapse as they reflect poor earnings or dividend cuts and omissions. I believe we're moving into the second phase now.

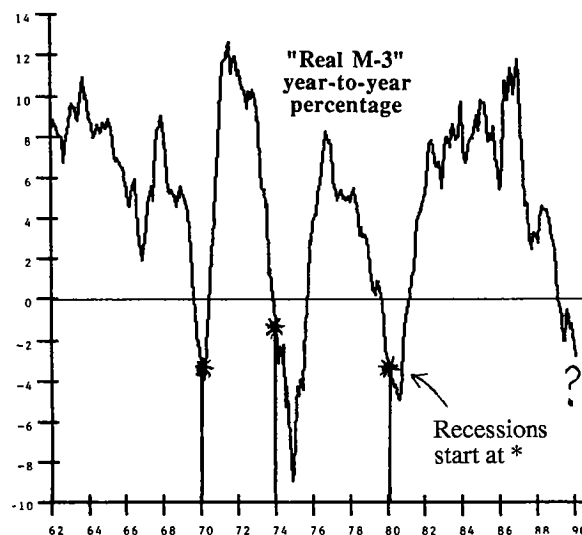
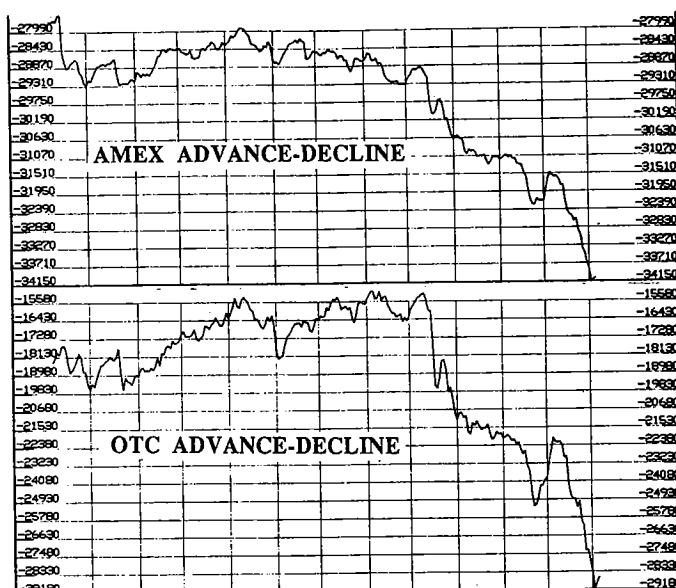
In the third or final phase of a bear market, stocks are sold for no other reason than to raise money for the sellers. This is the phase, wrote Robert Rhea, where "those who were saving for a rainy day wake up to find that it is raining."

Each bear market brings with it new problems, and this one is no exception. For one thing, this is the first bear market in modern history in which a large part of the monetary problems are outside US control -- by that I mean outside the control of the Fed, the Congress, or the Treasury. What I am referring to, of course, is that our bond markets are at the mercy of European and Japanese money rates.

Currently, inflation is heating up in both of these countries, and their bond markets have been sinking. Rising interest rates are the reverse side of declining bonds. The US sells its new issues of bonds at auction. So it's never a question of whether the Treasury bonds will sell, it's simply a question of what rates the bonds will go for. As interest rates rise overseas, the rates that will move T-bonds go up. This has nothing to do with the wishes of Congress, the President, or the Fed. The Treasury's bonds must be sold. The bonds, therefore, must be priced to attract foreign money.

NOTES: The two charts top right (courtesy of *Mansfield*) indicate the extent of the beating that many secondary stocks have taken so far. The charts also suggest that the bear market for a great many stocks began around June of last year.

The third chart (courtesy of Ed Hyman of *C.J. Lawrence*) is well worth studying. M-3 is a broad measure of money. "Real M-3" is M-3 adjusted (divided by) the Producer Price Index. The chart shows the year-to-year percentage change in Real M-3. In the past,



when this index dropped into negative territory, a recession began. The Index is deep in negative territory now. Asterisks indicate where previous recessions started.

INVESTMENT POSITION:

The bear is in the box, and personally, I'm very liquid. I can't prove it, but my feeling is that this is going to be a long, drawn-out, very difficult bear market, and that trading, messing around, moving in and out ("to catch the rallies") is going to be a prescription for losing money.



One of the reasons why this is going to be a complex and difficult bear market is that the markets are now totally global with stockholders getting up early in the AM to tune in on the price of the yen or the latest in German interest rates or whether Gorbys is still around. The influences on our markets (positive and negative) are now more complex than ever before. Today there's no simple analysis of the fundamentals. And I believe these global influences will make this a different (and more frustrating) bear market than any we have seen before.

DOLLAR DISASTER: According to the Congressional Budget Office, the real deficit for 1990 is \$276 billion, except that the government is borrowing \$135 billion from various trust funds, including \$65 billion from Social Security. This borrowing is used to pay the routine costs of governing. The money that is borrowed

from Social Security and other trusts is replaced with government I.O.U.s, "to be paid back another day."

This unconscionable practice obviously undermines the long-term security of the trust funds. It also undermines the economic future of our children and grandchildren, who will be saddled with an unbelievable compounding, rising mountain of debts.

Finally, the surging pile-up of debts and deficits undermines the dollar. I've written about this many times before, but I want to repeat it so that all my subscribers will understand what is happening.

The savings rate in the US is low, one of the lowest of any developed nation (now around 5%). These savings are not enough to finance the massive US federal deficits. Therefore, the Treasury depends on foreigners to buy roughly 20-40% of all new US debt. To put it another way, the current "high" US standard of living is being financed in large part by infusions of foreign capital. To that extent, the US (as least as far as its standard of living is concerned) is living on borrowed time and borrowed money.

But a few new factors have entered the equation. In 1992 the new European Community will become a reality. The European Community will have its own currency, the E.C. Unit. The Units will become the currency for all of Europe.

At that time (1992) European borrowers will very likely borrow or denominate an increasing amount of their bonds in ECUs. The ECU will then directly compete with the dollar. If Europeans perceive that the US is continuing to run deficits and debts, they will not only move increasingly toward ECUs, but they will move away from dollar denominated securities. The same can be said of Japan, which has regularly been buying around 30% of all new US debt.

On top of this, the nations of Eastern Europe (which have broken away from Russia and are, in many cases, nearly bankrupt) will need vast sums of money in order to rebuild their crumbled or almost nonexistent industrial structures. For this reason, money from Japan and Europe, which would ordinarily be slated to go to the US, will be siphoned off to Eastern Europe.

In the case of Japan, it is already clear the Japanese are making massive investments in Asia. Furthermore, the Japanese trade surplus has been declining for many months. Both of these items make it increasingly likely that Japan will be directing fewer funds to the US.

Those are the fundamentals, the big picture for the dollar. However, there are some other phenomena that could influence the direction of the dollar. One is that the rise of a strong European currency (ECU) will give Japan another place to put its money. Up to this point, the dollar (the world's reserve currency) and US T-bonds have been the only resources large enough to handle the immense amounts of Japanese capital (although the expanding German market is presenting a perfectly legitimate alternative).

Another variable in the equation is the US economy. It has been expanding without a recession for the past eight years. Our creditors must believe that it is only a matter of time before recession finally hits the US (if it is not doing so already). When recession hits, there will be a major shortfall in tax receipts to the US government. That will trigger a true deficit of up to half a trillion dollars. The possibility of that kind of deficit appearing can hardly be looked upon with equanimity by our creditors.

The US economy is now sloppy, and many sectors of the economy are now indisputably in recession. This would ordinarily be a signal for the Fed to drop interest rates. But it hasn't happened. Why?

The sliding dollar and the need for the US to compete (as far as interest rates are concerned) for foreign money is the unbelievably difficult problem the Fed has had to deal with. This is a problem

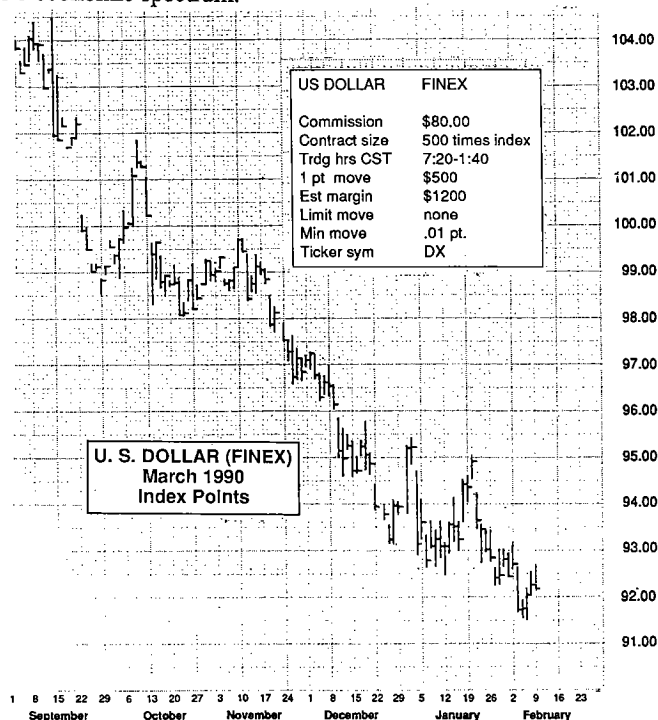
that none of the bond bulls foresaw (and every economist was a bull on bonds up to a few months ago).

But I'm stating here and now that the debt/deficit problems of the US -- and the government's refusal to deal honestly with those problems -- are pointing to a coming disaster. The debt, deficits, and weakening dollar are **THE CRITICAL ITEMS** that confront all investors today. Believe me, to ignore these problems is to be blind to one of the major forces in the global economy today. I don't care what stock you own or what bond you own, if the dollar continues to slide you will be dealing with losses.

As this is written, the President and Congress continue to debate the Moynihan bill to cut the Social Security tax. But we can see the dishonesty on the part of President Bush when he states, "Don't mess with Social Security." Don't mess with it!? It's already being messed with -- to the extreme. There is no cash or reserves being built up in SS. It's all being spent, and I.O.U.s are being slipped into the trust instead of cash. Mr. Bush, if that isn't messing with Social Security, I don't know what messing is!

The problem, of course, is that if the SS tax is cut and SS is put off budget, the \$65 billion that is stolen from the SS trust and used to disguise the deficit, that \$65 billion will show up as an increase in the deficit. "But if we put Social Security off budget, how do we make up the difference?" cry our Congressmen. I can tell them how to make up the difference. You either cut the fat out of the budget or you raise taxes. Take your choice. My bet -- the Administration will (as usual) play for time -- putting any hard choices out to 1993, 1994, and 1995.

But my own feeling is that the US budget deficit is a problem whose time has finally come. I don't think the dollar can continue to hold up against the kind of chicanery that we see in Washington. Where will the trouble appear? It will appear in the dollar and in US bonds and gold. In time, the dollar problem will permeate the entire US economic spectrum.



This chart (courtesy of *Dunn & Hargitt*) traces the recent action of the Dollar Index (which is weighted heavily in marks and yen). The Index has been going down hard, and may now be oversold. But the main direction is down, regardless of temporary rallies from oversold areas.

What do we do about it?

(1) I have been recommending gold coins and gold stocks for many months. As the dollar gets weaker, it will require more and

more dollars to buy an ounce of gold. Thus, a sliding dollar will drive up the dollar price of gold and gold shares.

(2) You can diversify out of dollars and into a foreign currency. There are a number of ways to do this. Shearson Lehman offers individual currency portfolios which are money market funds denominated in foreign currencies, and allows you to switch into any of four currencies (no load). Or you can open an account in a Swiss bank.

(3) You can buy an international stock fund. These funds hold foreign stocks. If the dollar weakens, it will require more dollars to buy these foreign stocks. Thus, a foreign stock fund will tend to be a hedge against the dollar (but remember, these stocks will also move with the trend of foreign stock markets).

BORROWING and DEBT: As most subscribers have undoubtedly guessed by now, I am not a big fan of debts and deficits. I realize that many businesses have to borrow in order to function. And I recognize that the bond market has a definite place in capitalism (although the bond and debt explosion of the 1980s overdid it, to put it mildly).

Along these lines, I was interested in a recent interview with John Templeton, the famous and highly successful portfolio manager (Templeton funds). Here's what Templeton said, "I do not believe in borrowing. When I finished college my wife and I agreed that we would save 50 cents out of every dollar that we earned, we would have no credit cards or charge accounts. We never bought a home on borrowed money. The first time I owned an automobile I paid over \$200 for a second hand one. The reason is that if you don't borrow -- but rather lend to other people -- they have to pay you interest instead of you paying them interest. And that's a very powerful factor. It's not wise to borrow even for good purposes, in my opinion.

"I have just told you, 'Don't borrow!' In fact, don't buy, rent. Wait for a down cycle. Buy your house when you have the cash to pay for it. And buy your house when there are lower prices." So says John Templeton, one of the great successes of the financial world.

Maybe I'm a fuddy-duddy, a product of the Great Depression, but those are my sentiments as well. I've written many times about the huge advantages of saving while you are young and then compounding your savings through the years. One undeniable advantage young people have is that they have many years ahead of them in which to compound.

Ironically, however, it is now standard practice for young people to marry and immediately go into debt as they buy a house, furniture, appliances, etc., via a mortgage and installment debt. Thus, they do exactly the wrong thing. Consequently, they spend the rest of their lives making interest payments to the bank instead of receiving interest and dividend payments through ownership of bonds, notes, and stocks.

Personally, I own my home free and clear as well as everything in it. I don't owe anybody a thing, and I like it that way. Only once in my life did I buy something on time. That was a Singer sewing machine which I bought about 20 years ago. Singer gave me a little booklet of bills, and each month I had to tear off one of those blasted little bills, put it in an envelope along with a check, and mail it to Singer. After a year of mailing those bills in I went down to Singer and told them I wanted to pay the damned thing off. It was more trouble than it was worth.

That ended any desire I ever had to owe anybody anything. Of course there's always borrowing with OPM, better known as "other people's money." That's a whole other story, and if you're interested in that approach, write to Henry Kravis in New York or Boone Pickens down in Texas. Kravis made \$360 million that way and Boone did all right too. But whatever you do, don't ask advice

from Robert Campeau or Nelson Bunker Hunt. Borrowing did neither of these fellows any good at all.

I've never met Campeau, but I've met Pickens and I've met Bunker Hunt. I can tell you that Pickens and Hunt are both nice guys. Neither of them mind using debt, although debt got Bunker into a heck of a lot of trouble.

Basically, you use debt when you want to get what you think you need but faster. The big boys use debt when they want to expand bigger or faster than their cash flow allows. In the end, debt is like fire. Control it, and it's useful. Let it get out of control, and it will create havoc. So far, I've done nicely without debt. In the years ahead, we'll see how the US does in handling its mountains of debt. It should be very, very educational.

NOTES & QUOTES: Anybody who was in combat during World War II has to have qualms about German unification. Let's face it, Germany's history isn't exactly conducive to calm (the Huns, the Nazis, the Kaiser, Bismark, Hitler, etc). Nevertheless, unification is going to happen, and Germany will be the economic center of Europe, with Japan most probably being the world's technical leader (Japan already has more engineers and scientists than we do). So as I see it, the US better get off drugs and stagger back to work. We can't compete in the world by selling hamburgers and real estate.

The OECD in Paris states that in 1989 West Germany tied with Japan with a trade surplus of \$61 billion. But in 1990, the OECD predicts that Japan's surplus will stay at \$61 billion while Germany's will zoom to \$71 billion. Thus, West Germany has become the economic engine of Europe. It doesn't escape some observers that the two axis powers of World War II are now leading economic powers and that Bonn, the new power center, is rising to challenge both Tokyo and Washington.

West German Chancellor Kohl is calling for immediate talks on establishing the W. German mark as the two states' common currency. If this occurs, it will require the issuance of millions of new marks, and many Germans (including the big banks) are afraid that this will trigger accelerating German inflation. The Germans are as terrified of inflation as Americans are of deflation. Meanwhile, W. German bonds are sinking and longer-term German bond rates are in the 8.5% range while short-term German bills are at 8.65%.

In Japan workers are expected to win wage boosts of around 6% this year, the largest increase in seven years. The Japanese bill rates have risen to 6.5% and the bellwether #119 government bond (due 1999) is yielding 6.32%.

Following "the Big Bang" of '86, London's stock exchange has really gone international. Of the 408 members of the exchange, 154 are now foreign-owned. London hopes to become THE international exchange.

Where our taxes go: Read it and weep. I've often thought -- all the taxes I pay in my lifetime will probably go to buy some unworkable piece of military junk. Anyway, this news clip tells a story:

New York Times News Service

spare parts, uniforms and other equipment that it does not need.

WASHINGTON — A Senate Budget Committee report sent to Defense Secretary Dick Cheney on Friday night asserts that the Pentagon has stockpiled at least \$30 billion in The report also says the Pentagon has orders in for \$1.8 billion more in supplies that its own auditors say should be canceled.

Nobody talks about the cowboy state of Wyoming (probably because it gets so unbearably cold in the winter). Wyoming is the least populated state in the nation with a total of 471,000 residents (in contrast, 421,000 people moved into California last year). BUT -- Wyoming has one of the lightest tax burdens per capita with no income, corporate, or inventory taxes, and property and sales taxes are low. Wyoming also boasts gorgeous, unspoiled scenery with Yellowstone, Grand Tetons and Jackson Hole.

What is it about coaching in the NFL -- at least where weight is concerned? Here are some statistics: Dan Henning of the Chargers, 222 pounds; Buddy Ryan of the Philly Eagles, 258 (and he's short); Joe Gibbs of Washington, 240; Chuck Knox of Seattle, 236; Bill Parcells of the Giants, 265. Slim Fast is offering six NFL coaches \$500 for each pound they lose. It's a good promotion. The program calls for two milkshakes in the AM, two more in the PM, and a balanced meal at night. And NO SNACKS. Wonder if these guys will survive!

First it was llamas, and now it's ostriches. My old friend R.E. McMasters first told me about llamas many years ago when prices were cheap. R.E. breeds these beautiful beasts, and in a recent auction, prices for top llamas went through the roof. The high prices were \$170,000 each for two prize breeders. Now ostriches have joined the game. Before the ostrich boom in the mid-'80s, baby birds sold for \$500 to \$1,000 a pair. Now a pair of eight-week old breeding chicks sells for \$5,000. The big birds are raised mostly in Oklahoma, where there are currently 115 ostrich ranches.

Questions keep coming in regarding where to buy foreign currencies. Bank of America has foreign currency accounts, but they say it is for big business only. Sumitomo has such an account, but they want a minimum deposit of \$500,000. The huge Swiss Bank Corp. with offices in NYC, San Francisco, Chicago, and LA offers a wide spectrum of investments including foreign currencies. Minimum account for an individual is \$100,000. I'll keep you posted.

I've never professed to understand George Bush. He somehow always seems to be in cloud-land with his talk about "a thousand points of light" etc. The strangest part of Bush is his seeming acceptance of China, first sending his ambassadors over to shake hands with the Chinese dictators and more recently approving Export-Import Bank and World Bank loans to China. Tony Lewis in a February 9 NY Times editorial writes as follows: "The Bush Disaster: When has a President responded so feebly to the challenge of historic change? When has the idea of American leadership been so mocked? The Communist Party is losing its monolithic grip on the Soviet Union. Soviet republicans are threatening to break away. Across Central and Eastern Europe freedom is rising.

"And how does George Bush respond? He goes on a tour to campaign for military spending. He asks Congress for new strategic nuclear weapon systems. He demands 25% more money for Star Wars. There's a grotesque quality to the President's performance. A Disconnection from reality."

The Feb. 9 WSJ joins the Times. "Bush's troop 'floor' in Germany rapidly becomes a ceiling instead. His new proposal to cut US troop levels is being overtaken by events. Germany's fast-moving reunification may mean a far greater and faster Soviet pullout than expected. Dems on Capitol Hill already begin pressing the Pentagon to accept deeper troop cuts." Russell comment: it's true -- events are happening faster than Bush can think. But he'll get in tune with what's happening. Just give him time -- and a bit of political pressure (note how Bush has faded away on the abortion issue).

State lotteries now operate in 33 states and in DC. The Feb. 20 issue of Financial World (a vastly improved publication, by the way) states that state lotteries are "the most regressive tax there is. They are unfair to the bettor. They are expensive to collect. The profits they generate can usually be replaced by a 1% hike in the sales tax. Typically, states pay lottery winners just 50% of the tax taken in. By comparison, slot machines pay back almost 90%. And casino table games pay almost 97% of the money bet to the winners." . . . According to the trade magazine, Gaming & Wagering Business, the total amount of money changing hands in legal and illegal gambling last year was a staggering \$252 billion, an increase of 67% from 1982. That's more than Americans spent on health insurance, dentists, shoes, foreign travel, or household appliances.

Speaking of morality, Hollywood may re-do Bud Schulberg's famous novel of back-stabbing greed, "What Makes Sammy Run?" Interviewed recently, Schulberg said, "What shocks me is how young people in and out of the movies perceive Sammy today. When I wrote him he was a terrible human being, scorned by everyone. By today's standards he's become a success. What's the world coming to? I read an interview with Donald Trump who was accused of being a supreme egotist. Trump said, 'I take that as a compliment.' If you asked Sammy Glick, he would take it as an insult even today. It's an indication of the change in our social mores."

In September 1987 a seat on the NYSE sold for a record high of \$1.15 million. That was a month before the crash. A few weeks ago a seat sold for \$365,000, down 68% from the high. Seat prices tend to mirror total market activity or at least Wall Street's perception of coming Exchange activity and profitability. In 1929, a seat sold for a then-record high of \$625,000. By 1940, a seat sold for a 20th century low of \$17,000. The trend of seat prices constitutes an interesting way of following or confirming the trend of a bull or bear market.

Well-known economist Gary Shilling is one of the few outspoken bears on the economy. In Forbes, Gary stated that he was selling short shares of California banks. When our local business editor (Don Bauder of the San Diego Union) spoke to Shilling last week he asked him why he would short stocks of California lending institutions. Gary said, "Because California real estate is going to hell and they're going with it." Russell comment: Please Gary, I'm just putting a two-room addition on my house.

I always return to the city of my roots, New Yawk. In the Feb. 6 Fortune, there's a fantasy letter (with a lot of truth in it) from a New Yorker to a friend. Here it is:

Dear Milton,

Happy New Year, where you are at least, I hope. In New York City everything's going to pot again. The schools are falling down, the hospitals are falling down, Wall Street is falling down, the sewers are blowing up. My son wants to buy an apartment, but who can afford to now? He's living in a luxury converted welfare hotel.

Then there's the crack and the smack and AIDS and the people sleeping in the Citi-bank. They open the door and ask for a quarter, finally some courtesy. Other than that there's a new mayor—I'm not saying it's good or it's bad, it just is—and he says he's going to be tough on crime. Now six people have to be shot instead of three before it counts as a shooting spree.

So how's Pensacola?

Harry

Some interesting NYC facts. Its population is 7.3 million, its per capita income is \$18,100, its city budget is \$26.6 billion, its public school enrollment is 923,000. In 1988 alone NYC had 1,915 homicides, 86,578 robberies, 128,626 burglaries, and 119,659 car thefts. In 1989 there were 609 water main breaks and 9,510 suits filed against the City. In 1950, 118 Fortune 500 companies made NYC their headquarters. By 1988, that number had shrunk to 48.

Moody's Investors Service expects 10% of all junk bonds to default in 1990, up from 1989's rate of 6%.

McDonald's restaurants may sound all-American, but look at this -- MCD has 11,000 restaurants in 51 foreign countries. The foreign outlets now account for almost one-third of sales. Growth in the US has been sliding, however, due to competition from supermarkets and convenience stores. The average number of MCD customers per store hasn't grown in five years. But now MCD is going after one of the major American food items -- pizza.

GOLD: There are few things on earth as strange and mysterious as the world of gold. Men have lived for it. Men have died for it. Markets have panicked when the price of gold rose. Nations have staggered when gold left their shores.

Many years ago, during the 1960s, my friend James Dines wrote that in due time the price of gold would cross the price of the Dow. At that time gold was selling at \$35 an ounce and the Dow was around 600. When he wrote that, the prediction seemed too far-fetched to even comment on. Time proved Dines correct, however, and a *Barron's* editorial termed Dines' forecast "one of the most fantastic investment calls on record."

But wait -- now Dines is doing it again! In his January 19 report he states, "We now make a comparable prediction: with gold around \$413 and the DJIA around 2668 we predict that these prices will cross yet again! When? The odds are high that the crossing will occur as early as this decade."

Could Jimmy Dines be right again? And if he is, how would it work? Would the Dow come down to 1500 or 1000 or even 800 or would gold rise to \$800 or \$1,000 or even \$1,500? Dines has not voiced his opinion. But if his prediction turns out to be correct, I would bet that gold and the Dow would cross at a level of around 1500 or lower. Of course, that's just a Russell guess, nothing more.

I'm receiving all kinds of data on gold. For instance, Japan holds a very small percentage of gold at its central bank. "If Japan boosts its foreign reserves to 5% in gold," states one service, "the effect on the yellow metal would be massive." Another report states that if Russia decides to back her bonds with gold instead of selling her gold, this would greatly aid the supply/demand equation for gold. South America is now a big producer of gold, but there is a question of a strike in the mines, and on and on.

I've been living with the action and the trend of gold since 1960. And as far as I'm concerned, the major mover in gold is not how much the mines are producing or the political situation in Brazil, it's strictly market sentiment. The sentiment can involve fear of long-term inflation, fear of a monetary collapse, fear of a banking system cave-in, or fear of a run on the dollar (or any other fear you can come up with).

"Why fear?" you ask. The answer: because people have to have a reason to hold gold which pays no interest, rather than dollars or bonds or mortgages or some other interest-bearing paper. People know that gold has a long history of retaining its purchasing power. In contrast, no paper currency in history has ever survived, much less retained its purchasing power.

My old friend R.E. McMasters in a recent letter notes that all kind of events ordinarily favorable to gold have been unable to move the metal skyward. The Russian bust-up, a weak dollar, fighting in Eastern Europe, rising oil prices, accelerating inflation on the producer price front, sliding bond prices, none of these has been able to rocket gold to new highs. R.E. correctly notes that when an item doesn't respond to what it's supposed to respond to -- it pays to be careful.

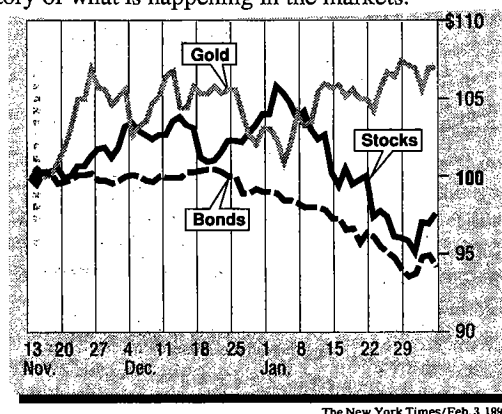
R.E. is right. But I have another "feeling" about gold at this time (and that's all it is -- a feeling). I think gold is in a long-term bull market, with an accent on l-o-n-g. And it's going to try our patience. If you're looking to trade gold (as a commodity), forget it. The current market is one of the toughest commodity markets I've ever seen (ask any commodity trader). No, gold is going to go its own way in its own good time, and I think we're just going to have to buy it (or the gold stocks) and SIT with it.

Just as gold has had every chance to break out on the upside, it's also had every chance to fall apart on the downside. It's done neither -- although it did give the bulls a good scare (see chart in the last Letter). But I'll stick to my instinct here. Gold will move up in due time.

S. Africa: Mr. Mandela, released from prison after 27 years, is a brave and tough leader. Among other things, he wants the S. African gold mines to be nationalized. Will that happen? Maybe eventually, but I believe such action is years away. Nevertheless, this possibility will hang over the S. African mining shares.

I dislike unsolvable problems in investing. The above fits my description of an unsolvable problem. Therefore, I personally will not buy the S. African shares. If you have them, I can't tell you what to do. Note that in my past recommendations, I stayed with gold coins and N. American shares, with the single exception of ASA. If you bought ASA on my earlier recommendation, you probably have a profit now. I'd be tempted to sell the stock. The S. African situation is an unsolvable problem for investors. There's no obvious answer.

This chart appears every Saturday in the *NY Times*. It tells a succinct story of what is happening in the markets.



LATE NOTES: Today if you want to zero in on the critical area, the place to look is the Bond Market Data Bank (in section three) of the *Wall Street Journal*. Then drop your eyes to the **International Government Bonds** box. There you'll see bonds from Japan, W. Germany, Canada, and the UK listed. Canadian bond yields have just risen to an eight year high, the Japanese yields are pushing to around 6.5%, the German two-year note is at 9%, and both Japan and Germany are showing inverted yield patterns (i.e., short yields over longs, indicating pressure in their money markets).

If E. Germany is to survive, it will require huge infusions of new W. German marks. This is putting pressure on the mark and arousing German fears of inflation. Inflation is heating up in Japan as well, and we can expect another boost in Japanese rates shortly. In the US, housing and auto sales have suddenly spurted. The global money markets are under pressure from the collapsing Russian empire, from rising inflation, from an unraveling of junk bonds in the US, and from huge US deficits that will appear this year and in coming years.

On the US stock market, shares (as this is written) are still rebounding from late-January's acute oversold condition. The recovery from an oversold situation is extremely important in judging the condition of the market. If the oversold situation is merely "worked off" with unimpressive upside action -- watch out. That's a bearish omen. So far, this rebound has been unimpressive. Since late-January we have seen only a single day with over 1,000 advances (that was on January 31). As I said, so far the rally is unimpressive.

Final word: Gorbachev is against the wall -- incredibly giving in to almost all US-European wishes and demands. Talk is of a Soviet Union very close to total collapse. Will the Soviet people "take it to the streets"? That's the big worry of the now thoroughly discredited and demoralized Communist party. Would anyone have believed this -- even a year ago?